

## MEMORANDUM

**DATE:** July 18, 2005

**TO:** Members of the House Tax Policy Committee

**FROM:** Peter Kuhnmuensch, Insurance Institute of Michigan  
Eric Henning, Michigan Insurance Coalition  
Larry Kish – Life Insurance Association of Michigan

**SUBJECT:** Single Business Tax History – The Insurance Industry

### 1975

- When Michigan adopted its modified value-added tax in 1975; in-state insurance companies paid the Single Business Tax in essentially the same fashion as all other businesses in the state. Foreign insurance companies paid SBT on their Administrative Services Only Contracts (ASO's), but paid a 2% of premiums tax on gross premiums for life insurers, casualty, title, and surety and fidelity companies. Foreign insurers of fire, marine and strictly automobile insurers paid a 3% gross premiums tax.

### 1985-87

- In June of 1985, Governor James Blanchard proposed taxing domestic insurance at 2% of gross premiums tax. Arguments for the change included questions regarding the constitutionality of the existing tax treatment of foreign companies, and a need for additional state tax revenues.

Through two Legislative sessions the negotiations continued until an agreement was reached during the final days of 1987. The elements of the agreement included the following provisions:

- Both foreign and domestic insurance companies would be taxed under the Single Business Tax.

- The tax base of an insurance company will be equal to .25 times its gross receipts, reflecting what would constitute its "value-added" base. The method of determining the base is the subtractive method, rather than the additive method. However, this method was used for ease of calculation and was equivalent to what other industry classifications pay.

- The industry was also assessed a surcharge of 126% times its basic SBT liability to provide sufficient revenues for the current state budget deficit. No other industry sector is assessed a surcharge under the Single Business Tax.

- Beginning in 1987-88, insurance companies (both domestic and foreign) would be allowed credits against their SBT liability for assessment paid to certain residual market mechanisms and guaranty associations. The credits were limited to ensure that taxes received from domestic insurance companies would be at least \$30 million. This \$30 million guarantee would be adjusted annually consistent with state general fund/general purpose revenue growth.

- A provision was included which provided that the tax treatment of insurance companies under the SBT was "in lieu of all other privilege or franchise fees or taxes imposed by any other law of this state." This language is typical in other states and reflects the higher tax burden that insurers must pay in comparison to other businesses.

As a result, most other taxes are not imposed on insurers. In fact, this is consistent in Michigan where part of the trade-off for insurers paying a disproportionate share of the SBT was that they would not be subject to other taxes, except real and personal property taxes (which is not necessarily true in other states - making Michigan insurers tax burden even higher when compared to other states). This is why insurers do not and should not pay the use tax.

- A retaliatory tax was incorporated into the state insurance code, as utilized in nearly every other state with the stated purpose of "protecting the domestic insurance companies from excessive or discriminatory taxation in other states" and to force those high tax states through competition to reduce their taxes on insurers.

## 1995

- The "insurer's exemption from gross receipts" that is referred to in Treasury's Annual Executive Budget Appendix on Tax Credits, Deductions and Exemptions, implies that this is the result of some special exemption that insurer's received because of a change in the statute in 1995. This is completely inaccurate.

In the mid-1990s, the Michigan Department of Treasury had attempted to collect a tax on reinsurance premiums that insurers received, even though the statute excluded these premiums from an insurer's tax base. When this was brought to Treasury's attention, a discussion ensued that perhaps the language delineating an insurer's tax base was not clear. It was agreed that the specific items which should be included in the tax base and items excluded from the tax base should be clarified.

Treasury and the insurance industry reached an agreement on the language that is reflected in the current law. This agreement did not give the insurers any special exemption, but merely reflected the reality of what was currently included in their tax base (their value added) but which had not been clearly stated in the statute. As a further indication that the change was made to reflect current law, the amendment was made retroactive to 1991, which is the audit limitation period, so that Treasury could not use the change to argue something different applied in a prior tax year.